Ec 7/5/989

gist

A quick reference aid on U S foreign relations
Not a comprehensive policy statement
Bureau of Public Affairs • Department of State

Structural Adjustment and Economic Performance June 1989

Background: Structural adjustment concerns relative prices, resource allocation, incentives, and opportunity costs. At the policy level it relates to such microeconomic issues as competition, government regulation, the operation of financial markets, subsidies, and tax and labor markets. These issues are not as well known as their macroeconomic counterparts--such as the trade deficit, inflation, growth, and foreign exchange--but they are equally important, if not more so.

Effect of government economic policies: Although the economic structure of most democratic countries is largely the result of the interaction of private parties in a free market, significant influence also is exerted by government laws, regulations, and procedures. The nature of a government's economic policies is crucial to an economy's efficiency and long-term growth prospects. For example, antitrust policies that keep markets open to new competitors will often encourage new inventions, promote increased productivity, and help improve the distribution of income and wealth. A steady pattern of government investment in roads, education, and other forms of social infrastructure may provide encouragement to, and facilitate certain types of, private investment. On the other hand, overly high taxes may be resented and discourage people from productive work. Unusually slow growth of the money supply might retard economic adjustment and growth, while a too rapid rate of money growth causes inflation. Controls on rents, prices, and wages may discourage home construction, inhibit investment, and create unemployment.

Economic policies have contributed significantly to today's large international trade imbalances. Agriculture may be the sector in which there is the most glaring and pressing need for international structural reform. Around the world farm subsidies are creating mountains of food that cannot be sold, distorting land use, exacerbating budgetary deficits, and impeding the efficient international distribution of labor and capital. Recent studies indicate that global budgetary and consumer costs total about $250 billion for agricultural subsidies.

Structural reforms: In the US, we have improved the structure of our economy by deregulating the transport and telecommunication industries, reforming taxes, and increasing competition in the financial sector. We also have called on other countries to undertake structural reforms and adjustments that will make their economies more responsive to supply and demand. With more market-oriented, open, and efficient economies, all countries will enjoy higher living standards and, as a result, international trade imbalances should be moderated.

In Europe, changes are needed in policies affecting wages, labor mobility, job security, and work rules if there is to be a sustained

READEX FICHE best copy available

S1.128:

reduction in unemployment. Rent controls, a lack of secondary mortgage markets, and other factors affecting real estate conditions throughout Europe have depressed residential construction toward its lowest level in the postwar period. That, in turn, has helped perpetuate unemployment in the building trades, diminished demand for consumer durables, and otherwise frustrated economic growth.

In Japan, recognition of international realities has led to reductions in tariffs and a number of other trade barriers. Tax, monetary, and financial policies also have been liberalized. With these changes and the strong appreciation of the yen, domestic Japanese demand has begun to replace exports as the driving force in the economy. Structural adjustment is underway. Japan still, however, needs to reduce cartel arrangements, simplify its distribution system, and eliminate other institutional arrangements that impede economic growth and interfere with the achievement of better balanced external accounts.

In developing countries, the importance of structural reform may be even greater than in industrialized ones. Restrictive trade policies, controls on international capital flows, protection of small monopolies, poor budgetary practices, and a host of other structural problems in developing countries greatly inhibit investment, growth, and employment. If such structural deficiencies were addressed, many developing countries would be better able to cope with their serious external debt problems.

Multilateral efforts: Policy support for meaningful structural reform has been an increasingly important part of recent efforts by the seven major industrialized countries to improve international economic relations and global economic growth. Ministerial meetings at the Plaza in New York and the Louvre in Paris and annual summit meetings in Bonn, Tokyo, Venice, and Toronto all cited the need for structural reform as part of the policy coordination process, leading to stronger, noninflationary growth. This process is expected to intensify at the 1989 Paris Economic Summit.

In 1987, the Organization for Economic Cooperation and Development (OECD) published a major study entitled "Structural Adjustment and Economic Performance" which outlined major structural problems in the industrialized countries and discussed strategies for coping with economic problems. In 1988, it prepared a subsequent report, "Progress and Priorities in Microeconomic Policies." This report documents progress by OECD economies in transforming the agreed policy conclusions into specific policy actions and lists priority areas for further action.

The US supports an ongoing OECD work program designed to focus attention on structural-microeconomic issues by the member governments. Annual OECD reviews of major economies will continue the recent practice of devoting one chapter to relevant structural issues in each country. In connection with the review, the OECD's various committees will deepen and broaden their analyses of structural issues relating to global economic trends.

Harriet Culley, Editor (202) 647-1208